

Hearing of the US Senate Committee on Banking, Housing, and Urban Affairs
Turmoil in U.S. Credit Markets: Impact on the Cost and Availability of Student Loans

Testimony by Mark Kantrowitz, Publisher, FinAid.org

Thank you Chairman Dodd, Ranking Member Shelby and the distinguished members of the Senate Committee on Banking, Housing and Urban Affairs for convening this hearing and for the opportunity to appear before you.

I am Mark Kantrowitz, Publisher of FinAid.org and Director of Advanced Projects for FastWeb.com. FinAid is the most popular free web site for student financial aid information, advice and tools. FastWeb is the largest free scholarship matching service.

Contagion from the subprime mortgage credit crisis has infected the education loan marketplace. There have been no successful bond issues for state loan agencies and no securitizations of private student loans since last fall. While there have been some securitizations of federally-guaranteed student loans, the volume is down by 57% year-over-year and the cost of funds has increased by 137 basis points. None of these securitizations have involved federally-guaranteed student loans originated since October 1, 2007. The auction-rate securitization market is dead. These problems are occurring despite the AAA-rating of the student loan securities.

The lack of liquidity has lead to an unprecedented exodus of education lenders from federal and private student loans. As of today, 57 education lenders have suspended their

participation in federally-guaranteed student loans and 19 lenders have suspended their private student loan programs.

In FY2006 these lenders originated more than \$6.5 billion in Stafford and PLUS loans to more than 800,000 borrowers and more than \$48.5 billion in consolidation loans to more than 1.6 million borrowers. That represents 13% of Stafford and PLUS loan volume and 67% of consolidation loan volume.

These lenders include 21 of the top 100 originators of federal Stafford and PLUS loans and 27 of the top 100 originators of federal Consolidation loans. The top 100 lenders originate 91.5% of Stafford and PLUS loans and 99.8% of Consolidation loans.

Last week Sallie Mae, the largest education lender, announced that it will no longer be making consolidation loans. The Education Resources Institute (TERI), the largest nonprofit guarantor of private student loans, filed for Chapter 11 bankruptcy. Nelnet sold \$1.2 billion of student loans for an after-tax loss of \$28 million. There have been more than 2,500 layoffs industry-wide.

The credit crisis has also had a direct impact on borrower eligibility for federal and private student loans. Borrowers with a foreclosure in the last five years are ineligible for the federal PLUS loan. There will be about a 10% increase in PLUS loan denials at the start of the 2008-2009 student loan season. Lenders are also tightening credit underwriting criteria for private student loans. Credit score requirements are increasing

from 620 to at least 650 and approval rates have dropped by 10% to 25%. Overall, more than 100,000 additional families will become ineligible for both the federal PLUS and private student loans.

The cost of federal and private student loans has also increased. Most lenders have cut their Stafford and PLUS loan discounts in half and have eliminated discounts on consolidation loans. More than a dozen private student loans have increased the interest rates by an average of 7/8 of a percent.

These are signs of a very serious threat to our nation's education financing system and cause for concern. Without loans, some students may be forced to drop out of college.

Existing solutions are inadequate. Neither the Direct Loan program nor the lender-of-last-resort program has been tested under the extreme conditions we face today. For example, Federal Direct Consolidation Loan volume will be more than four times last year's volume and more than twice the peak volume. Neither program addresses the liquidity problems that are forcing education lenders to exit the marketplace. Both are reactive solutions that offer the potential for significant disruption during any transition period.

It is better to implement proactive solutions that prevent a crisis. The most effective solutions will involve injecting liquidity into the student loan system. Three possible approaches include allowing the Federal Home Loan Bank and the Federal Financing Bank to invest in highly-rated student loan securities, allowing lenders to pledge highly-

rated student loan securities as collateral for the Term Securities Lending Facility and conducting a reverse student loan auction in which lenders would compete for US Treasury investment in highly-rated student loan securities. The third approach would set margins competitively and is of limited duration, minimizing the need to wean lenders off of a source of cheap capital.

Other proposed solutions are aimed at restoring investor confidence. These include standby loan purchase agreements, government insurance of bonds and securitizations against lender default and eliminating the index rate mismatch. (Currently federal education lenders receive income that is indexed to the three-month Commercial Paper Rate while their cost of funds is indexed to the LIBOR index. Eliminating this index rate mismatch would yield more predictable spreads and would simplify the structure of student loan ABS by avoiding the need for interest rate swaps.) These solutions would reassure investors by reducing some of the risks associated with investing in these instruments.

Chairman Dodd and Ranking Member Shelby, I once again thank you and the committee for taking an interest in ensuring the continued availability of education loans, and for inviting me to share my thoughts on the matter. I would be happy to answer any questions you may have.